

U.S. Department of Housing and Urban Development

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Audit-Related Memorandum 97-BO-114-0801

MEMORANDUM FOR: Nicholas P. Restinas, Assistant Secretary for Housing- Federal
Housing Commissioner, H

FROM: William D. Hartnett, District Inspector General, Office of Audit, 1AGA

SUBJECT: Review of Priority Purchaser Status
Yorkshire Village Apartments
Houston, Texas

In response to a request from the Deputy Assistant Secretary for Multifamily Housing Programs, we performed a review of the priority purchaser status regarding the preservation sale of Yorkshire Village Apartments. The Yorkshire Village Resident Council (Resident Council) has alleged that: 1) a relationship exists between the seller of the property and the proposed priority purchaser; and 2) the sale does not have resident support.

BACKGROUND

Yorkshire Village Apartments is a 248 unit project currently insured under Section 236 of the National Housing Act. It is located in Houston, Texas. A physical inspection conducted by HUD on June 19, 1996 rated the overall physical condition of the project as below average and the maintenance policies and practices as unsatisfactory. In addition to the physical inspection, the Houston Area Office performed a comprehensive management review on June 14, 1996. The overall rating of management operations was below average.

On March 28, 1996, the President initiated the Housing Opportunities Act to protect the tenants and to fund as many project sales to priority purchasers as funds would allow. The regulations define priority purchasers as a resident council, nonprofit organization, or a State or local government agency. Such projects were designated by the Congress as eligible to receive priority funding through August 1, 1996. In order to implement this legislation, HUD issued a number of regulatory waivers to streamline the sales process to enable Field Office staffs to

process and fund sales projects expeditiously.

In particular, on April 12, 1996, HUD shortened the tenant and State or local government comment period of the Plan of Action (POA) from 60 days to 14 days. The owner's submission to the tenants must indicate that the tenants have 14 business days in which to provide comments on the POA to the HUD State/Area Office. Once the POA is approved, the owner/purchaser must post a letter advising tenants of the approval of the POA. This notice provides tenants with HUD's reasons for the approval.

In addition, on July 1, 1996, HUD rescinded the six-month super priority purchaser marketing period which allowed owners only to accept bona fide offers from specific priority purchasers for the first six-month period beginning on the date of HUD acceptance of the Second Notice of Intent. Resident Councils and qualified community-based nonprofit organizations with majority resident support, were considered acceptable purchasers. During the second six-month period, an owner could accept an offer from all priority purchasers. The waiver allowed any nonprofit organization or State or local agency that agrees to maintain low-income affordability restrictions for the remaining useful life of the housing to purchase the project.

On July 1, 1996, HUD issued Preservation Letter Number 8. It clarifies HUD's position of what is a related party and the related party rule. The related party rule in Section 231(c) was created to assure that legitimate, independent nonprofits would have special purchase rights while preventing for-profit owners from setting up sham nonprofits for the purpose of buying back their own projects in pre-arranged sales transactions between related entities.

The Houston project is being sold to a community-based non-profit organization created by California-based consulting firm (American Housing Corporation) and law firm (Dressler, Rein, and Evans), and the seller, for the sole purpose of purchasing the project, with the start-up funds provided by a California-based non-profit (Sunset Non-Profit). The sponsor of the non-profit is a Dallas-based church (The Church of the Living God) and the majority of the Board Members are members of this church and live in the Dallas area. The only persons involved with the non-profit who reside in the Houston area, are the three resident Board Members (who, as discussed below, have little to no involvement with the sale).

The proposed purchasers of Yorkshire Village submitted the bona fide offer on December 14, 1995 and it was accepted by HUD on May 2, 1996. The POA was submitted on June 10, 1996. HUD granted final approval of the POA on July 17, 1996. The Houston Area Office has not yet requested preservation funding for this project.

SCOPE

We reviewed HUD's processing of the proposed sale of Yorkshire Village to ensure that the sale is being made to an eligible nonprofit priority purchaser as intended by Section 231(c) of the LIHPRHA. Further, our review looked into the concerns and allegations made by the Resident Council and that the proposed purchaser is not a priority purchaser under existing HUD rules.

Specifically, we looked into allegations that: 1) the sale is to a sham non-profit established and controlled by the seller to ensure a lucrative equity take-out; and 2) the residents do not support the sale and have had little input into the proposed sale.

Our review entailed reviewing documents and correspondences related to the sale of Yorkshire Village Apartments. Further, we interviewed HUD Houston Area Office staff; members of Yorkshire Village Apartment Resident Council; Texas Action for Cooperative Housing (a nonprofit housing advocacy group who has worked as the Resident Council's consultant); Board Members of Yorkshire Non-Profit Housing Corporation; the Bishop of the Church of the Living God; and a partner in the law firm of Dressler, Rein, and Evans. We also interviewed staff at American Housing Corporation and corresponded with its President.

We discussed our concerns with the Headquarter's Preservation staff on October 9, 1996.

Within 60 days, please provide us, for each recommendation made in the report, a status report on: (1) the corrective action taken; (2) the proposed corrective action and the date to be completed; or (3) why action is considered unnecessary. Also, please furnish us copies of any correspondence or directives issued because of the review.

CONCLUSION

Our review disclosed no evidence to suggest that the seller and the non-profit purchaser are a related party as defined in HUD's Preservation Letter Number 8. However, we found that the seller and consultants orchestrated the sale of Yorkshire Village to a non-profit group, created by them, who has had little to no involvement with the POA process and are not supported by the residents. As such, we have concerns that the best interests of the property, the residents, and the community are not being met. Further, our review disclosed concerns with the processing of the sale performed by the HUD Houston Area Office.

Our review disclosed that the Yorkshire Non-Profit Housing Corporation (Yorkshire Non-Profit) appears to be an entity, only on paper. The purchasing corporation has no track record, organizational substance, and an understanding of what is going on. The Board consists of four members of the Dallas-based, Church of the Living God, and three Yorkshire Village residents. It was owner/management agent of Yorkshire Village who assembled the Board of Directors of Yorkshire Non-Profit Housing Corporation. It was he who sought out the residents who are on the board and he who also solicited the members of the Church of Living God (where he works at times as their attorney). Later he sought the Church of the Living God to become the non-profit's sponsor.

The Board of Directors of Yorkshire Non-Profit have held no meetings, have not met (the resident-board members have not met the other board members), nor have they had input into the POA process. According to the President of Yorkshire Non-Profit, he and the other Dallas

members were elected to their Board positions by the Board of Directors of a project owned by the Church of the Living God in Houston. Neither the resident-board members nor the residents had any input into this selection process.

Our review disclosed that Yorkshire Village Apartments is not being sold to a community-based non-profit organization representing the residents that live there as they assert in the POA. In order to be considered a community-based non-profit the board must maintain at least one-third of its governing board's membership for low-income neighborhood residents, or elected representatives of low-income neighborhood organizations. The three resident-board members are merely figureheads. They have not been involved in the sale. Further, the residents do not support the sale in its current form.

The President of the Board of Directors of Yorkshire Non-Profit stated that he nor the Dallas Board members have met with the residents, the resident-board members, nor was aware of the residents concerns. Further, he did not know who was paying the non-profit's consultant (Rein, Dressler, Evans Law Firm), and unaware of where the start up costs for the non-profit came from. Ironically enough, the management of Yorkshire Village Apartments posted a letter to the tenants of Yorkshire Village Apartments on June 13, 1996 stating that the non-profit organization will be controlled by the tenants. Our review found this statement to be erroneous.

Our review disclosed no evidence to suggest that the non-profit is negotiating the best arrangement for the property and the residents. Yorkshire Non-Profit proposed, in the POA, \$100,601 in immediate required repairs and \$389,031 initial deposit to the Reserve for Replacement Account, to pay for repairs and replacements in the future. Required repairs is a deduction from preservation value. Required repairs must be completed within one year. The architect hired by the Resident Council assessed rehabilitation in excess of \$2.7 million compared with the \$489,000 in the POA. HUD's own PCNA, cited in the Form 9607, assumed a repair budget of \$1,134,314 for required/regulatory repairs and initial deposit to Replacement Reserve. Also, HUD, during a June 1996 Physical Inspection identified over \$450,000 in needed maintenance repairs and rated the physical condition of the project as below average. While the Resident Council disputed the repair figure, the purchasing non-profit requested less than HUD originally determined.

Further, we are concerned that the resident's concerns will not be adequately addressed. The Board of Director's President stated that the Board of Director's members in Dallas should be running Yorkshire Village along with their chosen management company. He stated that the few decisions made by the board so far, have been made by the Board members in Dallas. The resident-board of directors were not present nor made aware that the board members in Dallas met with the project's owner/management agent and signed the legal documents related to the sale nor were they involved in the selection of a new management company. Two of the three resident board members have indicated that they do not wish to be on the board and the third board member resigned.

The profit-motivated consultants who set this deal up, may not necessarily be concerned with assuring that the best interest of the project residents or local community are being met. Their purpose seems to merely create a non-profit entity that HUD will approve as an eligible priority purchaser. While all the documents submitted by the buyer's consultant were accurate and legal, the residents were never really involved with the sale or adequately represented by any of the parties involved with the sale.

HUD Field Office Inadequate Processing Of POA

Our review disclosed concerns with the processing of the sale performed by the HUD Houston Area Office. The HUD Houston Area Office granted final approval for the LIHPRHA sale of Yorkshire Village Apartments without giving the full amount of time it had specified to residents to submit comments on the POA or without adequately reviewing the Resident Council's concerns. Also we have concerns that the Houston Office did not adequately assess whether this sale was made to a non-profit that has the capacity to run the project in the best interest of the residents who live there.

Before the submission of the bona fide offer and onward, the Resident Council repeatedly wrote to the Houston Area Office, regarding their objections of the sale of Yorkshire Village to the non-profit. Responses from the HUD office were minimal. It appears that HUD did little to ensure that the Resident Council's concerns were adequately address.

Resident Support for the Sale

In response to a HUD Headquarters' request to the Houston Office to look into concerns raised by the Resident Council, in April 1996, the Houston Area Office reviewed these allegations. In particular, they reviewed the allegation that the residents did not support the sale. HUD regulations do not require resident support for the sale because the Bona Fide Offer was submitted after the six-month super priority purchaser marketing period. The Field Office did not realize that resident support was not needed for the sale. The Houston Field Office reviewed 24 of the 164 resident signatures, of which 21 were found to be authentic; and conversations with residents relative to meetings or their knowledge of the proposed sale, of which no definitive conclusion could be drawn. The proof of resident support provided by the non-profit was of resident signatures obtained in 1993. The non-profit was not even created until April of 1995. In summation, the Houston Office concluded that there may be a need for further review of the Agreement to Sale Document signed by the residents in 1993. No further review, however, has been performed by the Houston Office.

The HUD Houston Office accepted resident support signatures even though Yorkshire Village has a turnover rate of 15 units per month, which means that very few of the current residents gave their signature to support the sale. Also the Resident Council repeatedly told the office that the residents do not support the sale. Further, at this time in 1993, the residents had no knowledge

of the make-up of the corporation, they were merely supporting the sale. Also the Field Office accepted the out-of-date signatures from the non-profit. We believe that the Houston Office did not adequately ensure that the residents supported the sale.

Plan of Action Approval

The Plan of Action, dated June 1, 1996, for the sale of Yorkshire Village Apartments was submitted to the Houston Area Office on June 10, 1996. On April 12, 1996, a change in HUD's policy reduced the time period (from 60 to 14 days) in which interested parties could submit comments concerning the POA. However, the notice posted to tenants stated that residents had until July 31, 1996 to respond. The HUD Houston Field Office was aware of the comment deadline date, but gave final approval of the POA on July 17, 1996.

The Houston Office approved the sale without reviewing the Resident Council's concerns that Yorkshire Village was being sold to a "sham" non-profit established and controlled by the seller. Further, the Field Office approved the POA which proposed to retain Fleming Properties, the current management company, which is owned and controlled by one of the current owners. In two separate Physical Inspection Reports performed in May and in July 1995, the management company was rated as unsatisfactory (the poorest category) for overall physical condition and maintenance policies and practices. In addition, before POA approval, HUD conducted a physical inspection on June 19, 1996 and rated the overall physical condition of the project as below average and the maintenance policies and practices as unsatisfactory. In addition to the physical inspection, the Houston Area Office performed a comprehensive management review on June 14, 1996. The overall rating of management operations was below average. Given that the non-profit was newly created and had no previous experience, we question whether the Field Office should have approved the POA with an unsatisfactory management company.

Although the Resident Council strongly disapproved of the sale, and made its intentions widely-known, final approval was given on July 17, 1996. The Houston Field Office did note, on the final approval letter, that Preservation Value will need to be recalculated, based on assessment of repair needs and outstanding debt at the time incentives are granted.

The Director of Multifamily in Houston advised us that, due to the pressure of possible litigation by the seller and his consultants, regarding the amount of time it was taking the Houston Area Office to process the sale, he granted preliminary approval for the sale on July 17, 1996. Our review of the files indicated that it was final approval, not preliminary, that was granted on this date. Subsequently, during our visit, on September 5, 1996, the Houston Area Office advised the seller's consultant in a letter that preliminary approval has only been granted, not final approval.

On July 19, 1996 (two days after final approval was given) the Houston Office met with representatives of the Resident Council, the Texas Action for Cooperative Housing and HUD's Tenant Alliance to listen to their concerns regarding Yorkshire Village Apartment's

POA. The program staff advised them to submit a letter to the Houston Area Office outlining their concerns. HUD staff did not tell them that final approval had already been given. On July 31, 1996, the Resident Council submitted comments to the POA including a petition signed by 131 resident supporters of the Council, a clear majority of the 238 occupied units, in support of these recommendations.

The comments were the same concerns that they have been sending to HUD over the past year, namely that the proposed purchaser is not eligible; required repairs were inadequate; and a new management company was needed. As of September 6, 1996, the HUD Houston Office had not responded to these comments. However, this time, according to the Director of Multifamily Housing, they intend to evaluate these concerns but plan to wait until the beginning fiscal year 1997 before any decisions regarding the sale are made. At that time, they intend to hold a meeting between all the parties to the transaction to determine just what needs to be done to make the sale a "clean transaction."

Recommendations

We offer the following recommendations for your consideration:

- 1A. Assess whether the Yorkshire Village Housing Non-Profit represents the kind of priority purchaser that Congress and HUD intended or whether this non-profit actually represents a "sham" organization that is not truly benefitting the residents and the community but the seller.
- 1B. Determine whether the non-profit has the capacity and the aspiration to run the project in the best interest of the residents who live there.
- 1C. Determine whether final approval can be legally retracted since it was given (as attempted by the HUD Houston Field Office).

Distribution

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